Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users

4th August 2017

Market overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7474.77	▲0.427	▲1.32	▲12.7	7547.63	6634.4	2/6/17	3/8/16
FTSE 250	19908.2	▲0.145	▲3.04	▲17.1	20024.9	16997.1	26/5/17	3/8/16
FTSE SmallCap	5702.95	▲0.53	▲2.03	▲20.2	5702.95	4744.36	3/8/17	3/8/16
FTSE AIM 100	4997.49	▲0.401	▲3.87	▲37.9	4997.49	3624.67	3/8/17	3/8/16
S&P 500	2472.56	▼-0.116	▲1.79	▲14.3	2477.83	2085.18	26/7/17	4/11/16
UK Treasury 10 Year Par Yield	1.21	0	▼-5.47	▲36	1.54	0.61	26/1/17	12/8/16
Brent Oil Spot $	$52.775	▲2.25	▲6.39	▲21.5	$56.965	$43.44	29/12/16	3/8/16
Gold Spot $ per oz	$1269.32	▲0.726	▲3.74	▼-6.41	$1360.29	$1128.22	4/8/16	15/12/16
GBP/USD - US Dollar per British Pound	1.31463	▲0.536	▲1.53	▼-1.35	1.34149	1.20401	6/9/16	16/1/17
GBP/EUR - Euros per British Pound	1.10625	▼-1.12	▼-2.83	▼-7.43	1.1972	1.10625	18/4/17	3/8/17

Top 10 FTSE All-Share winners

No.	TIDM	Name	%chg 1w
1	MCLS	McColl's Retail Group Ltd	▲24.8
2	FDM	FDM Group Holdings PLC	▲19.1
3	CMBN	Cambian Group PLC	▲12.6
4	NXT	Next PLC	▲12.1
5	FOUR	4imprint Group PLC	▲11
6	HFG	Hilton Food Group PLC	▲10
7	PDG	Pendragon PLC	▲9.73
8	COB	Cobham PLC	▲8.59
9	XPP	XP Power Ltd	▲8.44
10	LMI	Lonmin PLC	▲8.11

Top 10 FTSE All-Share losers

No.	TIDM	Name	%chg 1w
1	GMS	Gulf Marine Services PLC	▼-35
2	SDL	SDL PLC	▼-24.6
3	AA.	AA Ltd	▼-13.5
4	MAB	Mitchells & Butlers PLC	▼-12.3
5	JE.	Just Eat PLC	▼-8.64
6	IMI	IMI PLC	▼-8.24
7	ROR	Rotork PLC	▼-8.21
8	CTEC	ConvaTec Group PLC	▼-7.66
9	HSW	Hostelworld Group PLC	▼-7.52
10	NANO	Nanoco Group PLC	▼-7.24

High flying AIM shares

We are still in the midst of a bull market from what I can see. This is particularly true when it comes to AIM shares. In this kind of market a momentum strategy - buying what has already gone up in price - tends to work very well until it doesn't.

The table below ranks the best performing shares in the AIM 100 between February and May this year and their subsequent performance in the following three months from May to August. I have also included a column to show what has been happening during the last month.

What you can see - with a few exceptions - is that what performed well has continued to do so. Shareholders have made some handsome gains.

Yet I can't help thinking that some kind of casino mentality has now crept into these kind of shares - if it hadn't already done so. The reason I say this is that many of the shares concerned already trade on very high valuations. What this means is that very high rates of profits growth are already baked into their share prices. But if profits beat expectations and analysts upgrade their forecasts the shares seem to go up. Rest assured, this will not continue forever.

No.	TIDM	Name	%chg 1/2/17 to 30/4/17	%chg 1/5/17	%chg 1m	TTM PE
1	FOG	Falcon Oil & Gas Ltd	▲310	▼-2.63	▲3.93	
2	IQE	IQE PLC	▲52	▲92.8	▲43.5	40.8
3	PURP	Purplebricks Group PLC	▲51	▲50.6	▲2.42	
4	SOLG	SolGold PLC	▲50	▼-12.6	▼-2.55	
5	KWS	Keywords Studios Plc	▲49	▲45.6	▲58.6	105.7
6	PRSM	Blue Prism Group PLC	▲48	▲27.8	▲12.3	
7	IGR	IG Design Group PLC	▲43	▲4.56	▲8.46	28.5
8	HOTC	Hotel Chocolat Group Ltd	▲36	▼-8.27	▼-12.1	
9	BOO	boohoo.com PLC	▲36	▲25	▲1.56	108.8
10	HCM	Hutchison China Meditech Ltd	▲35	▲15.4	▼-5.19	204.9
11	JOUL	Joules Group PLC	▲34	▲6.07	▼-1	39.1
12	AMS	Advanced Medical Solutions Grou...	▲32	▲15.5	▲5.17	40.1
13	TCM	Telit Communications PLC	▲28	▼-28.9	▼-15.3	24.9
14	FEVR	Fevertree Drinks PLC	▲27	▲33	▲27	67.7
15	WJG	Watkin Jones PLC	▲26	▲14	▼-0.946	11.2
16	TEF	Telford Homes PLC	▲26	▼-6.87	▲1.38	10.9
17	CVSG	CVS Group PLC	▲26	▲0.798	▲5.28	64.5
18	QTX	Quartix Holdings PLC	▲25	▲1.37	▼-3.9	29.0
19	HUR	Hurricane Energy PLC	▲24	▼-50	▼-9.62	491.7
20	TAP	Taptica Ltd	▲24	▲31.9	▲9.03	20.6

I take my hat off to people who can exploit this kind of behaviour although not many are capable of doing this for long periods of time. To me this is not investing; it is a form of speculation with the hope that you can get out whilst the going is good. This is hard to do as the temptation is always to hang on in there to make further gains. Very few of the shares listed above can justify the very high valuations that some of them command in my view.

My twitter feed is full of people reporting fantastic profits from some of the shares above. Unsurprisingly, there is not much talk of shares that do not work out well. Yet arguably, all that is happening is that they are being compensated for the big risks they are taking.

Valuation is of secondary or no importance at this point in time but eventually it does matter. Legendary value investor Benjamin Graham summed this up by saying that in the short run the stock market was a voting machine - pushing up the prices of popular stocks - but in the long run it was a weighing machine. History has proved him to be correct on this time and time again.

None of us can predict the future and therefore be certain that all of these shares are surefire long-term winners even if the market has priced them as such. There is no room for disappointment with many of the shares listed and any setback exposes the shareholder to potentially big share price falls. I saw this happen in the late 1990s and early 2000s when many private investors realised that shares can and do go down in price.

I ask myself whether the shares of companies such as boohoo.com and Purplebricks have reached the end of their momentum given the slowing price momentum during the last month.

Value investors take the opposite approach to momentum investors. They look for shares where expectations are too pessimistic and valuations are too low. This is not easy to do and can see many people just buying cheap and inferior shares. However, if good value investors are wrong but have bought at a price that limits their downside risk -often referred to as a margin of safety - then they often escape relatively unscathed. The same cannot be said for momentum investors.

Share Discussion: XP Power (LSE:XPP)

(Disclosure: At the time of writing Phil Oakley owns shares in XP Power)

XP Power shares have proven to be somewhat of a rarity in the current UK stock market. By that I mean that up until very recently it was an example of a high quality business with good growth that could be purchased for a reasonable valuation.

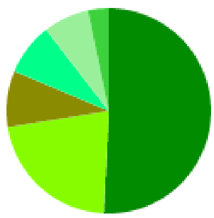
As you can see from the share price chart above its shares have performed very well in 2017. Back in March when I last looked at the company its shares were trading on just over 17 times 2017 forecast earnings. Today they are changing hands for over 22 times forecast earnings.

I think XP Power is an extremely good business and is a great example of a company thriving in a very competitive industry. For those of you who have never come across this company before, here is a brief description of how it makes money.

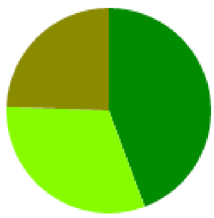
The company makes power control systems which convert power from an electrical mains supply to a safe level to be used in its customers' products.

It sells its products into the Industrial, Healthcare and Technology sectors where they are used in thousands of different applications. It does not have any direct exposure to the consumer electronics sector.

ACTIVITY BREAKDOWN



Region	Turnover	%
North America	55.7m	50.8%
United Kingdom	23.8m	21.7%
Germany	9.7m	8.8%
Other Countries	9.0m	8.2%
Singapore	7.9m	7.2%
Switzerland	3.6m	3.3%



Product	Turnover	%
Industrial	48.6m	44.3%
Healthcare	34.3m	31.3%
Technology	26.8m	24.4%

The bulk of the company's sales are made in North America and Europe.

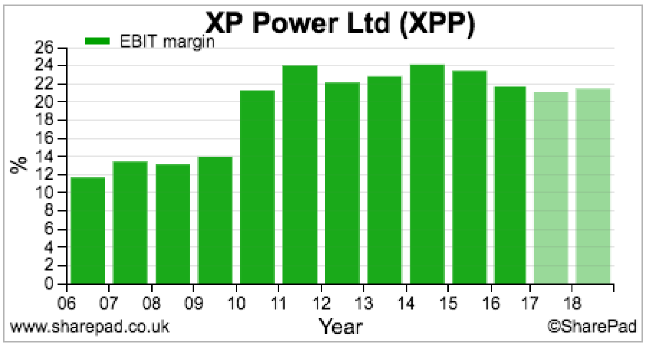
XP Power aims to differentiate itself from its competitors by creating products with the following characteristics:

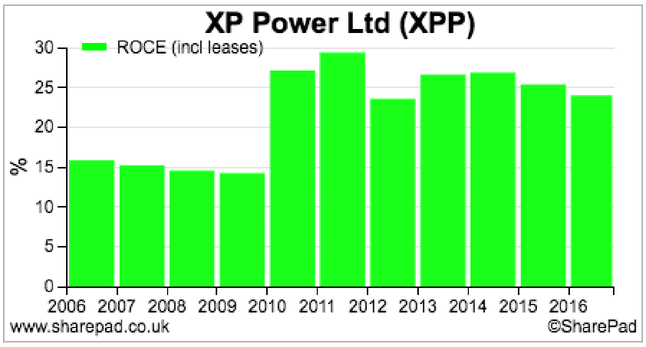
- Use less power
- Take up less space in a product
- Easy and fast to install
- Reliable

The company uses its own direct sales force to forge long-lasting relationships with customers whereas many of its competitors sell through third party distributors. Once a product is sold to a customer, XP Power receives a revenue stream over the product life cycle which is typically 5-7 years.

It's easy to think that XP Power is operating in a fiercely competitive industry selling commoditised products. However, its historical financial performance is very impressive to say the least. It ticks a lot of boxes when looking for hallmarks of a high quality business.

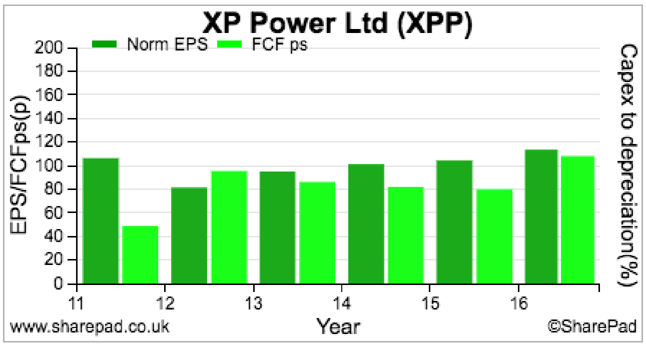
It has consistently high operating margins.

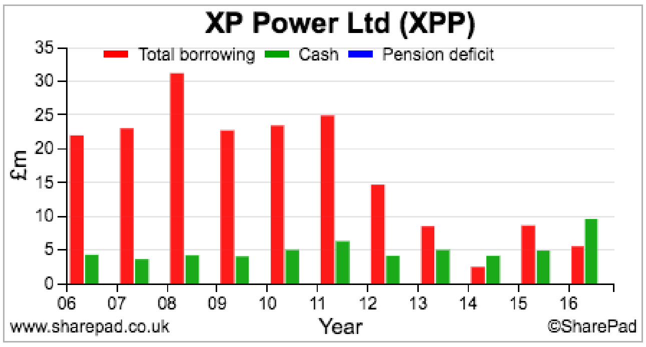




High returns on capital employed (ROCE).

It turns most of its profits into free cash flow.

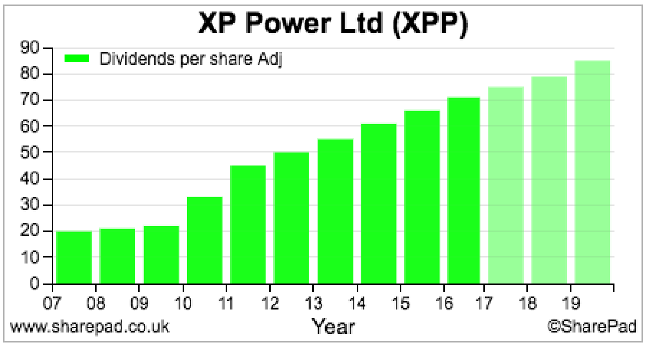




Has little debt or pension fund deficit.

And has been increasing its dividend payments to shareholders.

There is a little bonus for XP Power shareholders in that it pays quarterly dividends. This can provide a nice boost for anyone following a dividend compounding strategy by reinvesting their dividends.



Half year results released this week revealed that the company is firing on all cylinders even when the benefits of the weaker value of the pound - which increases the value of overseas profits - are taken into account. Sales were up by 33% but order intake was up by 52% giving a book to bill (orders to revenues) ratio of 116% which is what you want to see with a manufacturing business.

There was a slight reduction in profit margins due to currency effects pushing up costs faster than revenues. I don't see this as something to worry about too much. I would be more concerned if margins were under pressure due to rising competition which doesn't seem to be the case.

In fact, XP Power seems to be strengthening its competitive position. It is winning a larger share of its customers' business through new energy-saving products and is beefing up its manufacturing capacity in Vietnam to capitalise on this.

The company is in rude health and has £8m of net cash on its balance sheet. This gives it the firepower to invest in production and make bolt on acquisitions to broaden its product ranges.

Shareholders would have been pleased to read that profits for 2017 are now expected to be comfortably ahead of expectations and the announced dividend increase of 6.9%.

XP Power Ltd (XPP)

Prev Next	2013	2014	2015	2016	2017	2018
Fiscal period ending	31/12/13	31/12/14	31/12/15	31/12/16	1/12/17	1/12/18
£ millions unless stated	Q4	Q4	Q4	Q4	Forecast	Forecast
KEY FORECASTS						
Turnover	101.1	101.1	109.7	129.8	148.5	155.4
EBIT	23.1	24.4	25.7	28.2	31.3	33.4
Norm Pre-tax	22.9	24.3	25.7	28.2	31.5	33.4
EBIT margin	22.8	24.1	23.4	21.7	21.1	21.5
EPS(p)	95.1	101.1	104.4	113.3	124.8	132.1
EPS % chg	▲17.0	▲6.3	▲3.2	▲8.6	▲10.2	▲5.8
DPS(p)	55.0	61.0	66.0	71.0	75.0	79.0
DPS % chg	▲10.0	▲10.9	▲8.2	▲7.6	▲5.6	▲5.3
Dividend cover	1.7	1.7	1.6	1.6	1.7	1.7

I've no idea if more upgrades will be forthcoming. All I do know is that this looks like a business with a nice following wind behind it. It has a good track record in bringing, new better products to market and seems well placed to tap into the trend of more energy-efficient electrical products.

TIDM	Name	Close	Market Cap. (m)	fc PE	fc Yield	EPV ps (8%)	EPV % of EV (8%)	fc PEG
XPP	XP Power Ltd	£27.50	£529.2	22.0	2.7	£14.378	51.8	3.8

This rosy outlook does not come cheaply at the moment but compared to some companies out there XP Power's valuation does not look excessive.

Share Discussion: Revolution Bars (LSE:RBG)

(Disclosure: At the time of writing Phil Oakley owns shares in Revolution Bars)

Back in March I analysed Cuban-themed bar operator Revolution Bars in one of my regular stock watch articles (click **here** to read it). The share price at the time was 224p.

My view at the time was that the shares were up with events and not particularly cheap or expensive. I expressed concerns about slowing like-for-like sales, questioned the true ROCE being earned on new bar openings and also the credibility of analysts' EPS forecasts due to rising cost pressures.

In May, the company announced a profit warning due to rising costs and the fact that new bars had taken a little longer to get up to speed than expected. The shares duly tanked and drifted lower as people speculated about the possibility of another profit warning and the credibility of the management team.

A vague trading statement last week made no mention of cost pressures but seemed to indicate that the ship might have steadied a bit and the share price went up on the back of it.

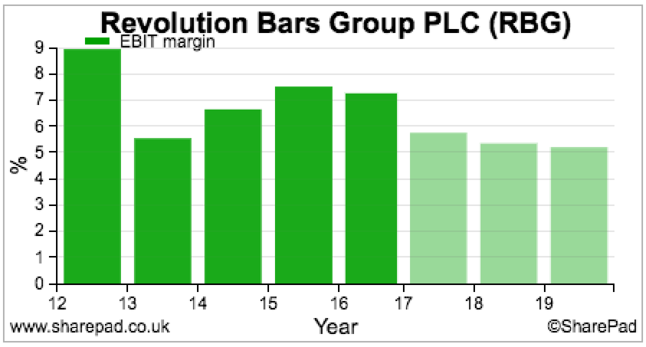
This week, the company announced that it has received a potential takeover offer at 200p per share from Stonegate Pub Co, the owner of brands such as Slug and Lettuce, Walkabout Inns and Yates. Stonegate is currently undertaking due diligence but there is no guarantee that it will make a formal bid for Revolution Bars. It has until 28th August to make up its mind.

Hindsight is a wonderful thing but it does tell us two things in relation to Revolution Bars. Firstly that the shares were oversold but also that the assets are probably worth more in the hands of another operator than the current one.

As I have written many times during the last couple of years I am not a massive fan of pubs as investments and Revolution Bars never grabbed me. Generally speaking, the pub market is too competitive, requires lots of money to stay competitive and produces modest or poor returns on investment.

I particularly dislike leased or rented pub operators as they lack the flexibility to adapt when trading gets difficult. This is one of the reasons why JD Wetherspoon - a very good pub operator in my opinion - continues to buy itself out of lease agreements.

Freehold operators have the option of selling pubs if trading becomes difficult. From an investor's point of view that asset backing can have substantial property value and provides a degree of protection to their investment as well as a source of cash for dividend payments.



One of the things that concerns me about Revolution is its poor operating margins. It sells expensive cocktails which are extremely profitable and allow it to earn gross margins of more than 70%. Yet its operating margins in 2016 were around 7% and will be less than that in 2017.

On the right is a breakdown of how Revolution's costs have affected its margins over the last three years.

RBG % of sales	2016	2015	2014
Cost of sales	23.9%	24.3%	25.2%
Depreciation	5.2%	5.6%	5.4%
Rents	7.4%	9.1%	9.1%
Payroll costs	28.1%	26.4%	25.7%
Other	28.1%	27.2%	29.1%
Exceptional	1.2%	4.8%	3.1%
Total costs	93.9%	97.3%	97.6%
Operating profit	6.1%	2.7%	2.4%
Adj operating profit	7.3%	2.7%	5.6%
Gross profit margin	76.1%	75.7%	74.8%

Serving cocktails and food is very labour intensive and payroll costs as a percentage of sales have been rising and putting pressure on margins again in 2017. The high gross margins not feeding through to operating profit margins may also be a sign that Revolution is not selling enough of its expensive drinks to cover its fixed costs - a sign that perhaps the locations of its bars do not attract enough affluent customers. This is a good enough reason to stay clear of the shares as a standalone investment in my view.

At the moment these concerns are largely immaterial. The issue is that Stonegate probably thinks that it can earn more money running Revolution's 68 bars than the current management can. It is likely to be viewing the company as an asset deal rather than taking over the format.

This makes sense. Stonegate is much bigger than Revolution. It has 690 pubs across the UK and in its last annual accounts to September 2015 reported sales of £561m and operating profits of £69.6m - a margin of 12.4%. Its much bigger size means that it will have better buying power with suppliers which should automatically feed through to higher margins and profits.

It is potentially offering £100m for the whole business - this is the enterprise value as well as there is no debt - which suggests that it has the potential of earning a good return on this deal. A lot depends on how Stonegate intends to trade the bars. Will it keep the Revolution format or convert them to one or more of its existing brands?

But let's say that Stonegate could earn an average 10% profit margin - less than its average - on Revolution's bars. That would give it trading profits of around £13m or a return on investment of 13% at a 200p takeover price (£100m). That would look to be a very good deal and perhaps lead to accusations of Revolution being sold off too cheaply.

A £130m purchase price would still give Stonegate a 10% pre-tax return on investment and would equate to a takeover price of 260p per share. However, the devil is in the detail when it comes to valuing businesses. It's nowhere near as simple as plugging a few numbers into a spreadsheet.

The risk is that Stonegate will find something that it does not like when doing its due diligence. This would not be totally surprising given that Revolution has had three finance directors during the last year and announced last week that its accounting of supplier rebates had been a touch aggressive.

I have also raised concerns that Revolution may be under-depreciating some of its assets (click **here** to read why I think this might be a possibility). So there are grounds for concern that Revolution might not be as profitable as it first appears.

The market clearly thinks that there is a chance that a takeover bid will not happen as the shares still trade at more than a 10% discount to the indicated 200p bid price. Usually this would attract the attention of merger arbitrage investment funds who would look to lock in a source of riskless profits but it seems this has not happened yet.

This means that there is a potential trading opportunity in Revolution Bars and one that has tempted me to have a little bit of a risky punt in the shares. But what if the bid does not happen?

Well the shares would probably fall back a reasonable amount. However, I think that this company is now in play regardless and that the current management team has effectively put up the white flag.

I view Revolution Bars as an underperforming asset that another management team with a different operating model can realise more value from. Time will tell as to whether this proves to be the case.

Share Discussion: James Halstead (LSE:JHD)

Flooring company James Halstead is a top quality business and one that I'd be happy to own shares in at the right price. It has a ROCE of more than 30% and is a good generator of cash. This is all underpinned by a sensible management team with a good business strategy.

However, as I noted in my stock watch back in June (click **here** to read it) this is all well and good but the company is finding it hard to grow its sales and profits by meaningful amounts. Sales growth has been anaemic since 2012 whilst profits last year benefitted from a large swing in stock profits and suggested that underlying profits went backwards.

Stock profits arise when a company writes down the value of stock from its cost to its realisable value due to changing trading conditions. In 2015 JHD's profits were reduced by £3.5m of stock write downs. Last year they were boosted by a £1.5m write back to previously written down stocks - a positive swing of £5m year on year.

This week the company released a very brief full year trading statement for the year to June 2017 which stated that growth remains difficult to achieve:

> *"In the Chairman's statement announced on 29 March 2017, it was noted that for the first six month's trading a slow-down in the UK market and adverse price pressure on raw material and overseas sourced goods were holding back the benefits of export currency gains. This continued in the second half year and* ***was exacerbated by a number of major distributors in the UK reducing stock levels****.*
>
> *Notwithstanding this backdrop we are confident of once again reporting record turnover and profits for the year to 30 June 2017."*

The fact that major distributors in the UK are reducing stock levels is not a good sign. Whether this will lead to an increase in orders once stock levels have gone too low or it is a sign of a weakening market remains to be seen.

I do not view this development in a positive light and think that there now has to be some risk that forecasts for the year to June 2018 are under some pressure.

James Halstead's share price has been similar to a tyre with a slow puncture since peaking at over 540p earlier this year. Yet at 433p it still trades on over 23 times forecast EPS. Unless growth picks up it would not surprise me to see these shares keep on falling.

James Halstead PLC (JHD)							
← Prev Next →		2013	2014	2015	2016	2017	2018
Fiscal period ending		30/6/13	30/6/14	30/6/15	30/6/16	1/6/17	1/6/18
£ millions unless stated		Q4	Q4	Q4	Q4	Forecast	Forecast
KEY FORECASTS							
Turnover		217.1	223.5	227.3	226.1	236.0	245.0
EBIT		40.6	42.1	44.7	46.0	-	-
Norm Pre-tax		40.4	41.6	44.1	45.5	48.0	50.0
EBIT margin		18.7	18.8	19.7	20.4	-	-
EPS(p)		14.5	15.0	16.3	17.0	18.0	18.8
EPS % chg		▼-1.2	▲3.9	▲8.2	▲4.3	▲6.0	▲4.4
DPS(p)		8.8	10.0	11.0	12.0	13.0	14.0
DPS % chg		▲9.4	▲14.3	▲10.0	▲9.1	▲8.3	▲7.7
Dividend cover		1.7	1.5	1.5	1.4	1.4	1.3

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